Audit Report

OIG-04-022

Management Letter for the Fiscal Year 2003 Audit of the Department of the Treasury Financial Statements

February 18, 2004

Office of Inspector General

Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

OFFICE OF
INSPECTOR GENERAL

February 18, 2004

MEMORANDUM FOR BARRY K. HUDSON
DEPUTY CHIEF FINANCIAL OFFICER

FROM: William H. Pugh
Deputy Assistant Inspector General for Financial Management and Information Technology Audits

SUBJECT: Management Letter for Financial Statements Audit

We have audited the Department of the Treasury's (the Department) fiscal years 2003 and 2002 financial statements and have issued our report thereon dated November 14, 2003 (OIG-04-003). In planning and performing our audit of the Department's financial statements, we considered its internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on internal control. As a result, we identified and reported two matters involving internal control and its operation that we consider to be material weaknesses and one other reportable condition as defined under standards established by the American Institute of Certified Public Accountants.

During our audit we also identified other matters involving internal control and financial reporting, not required to be included in our audit report, that we believe offer opportunities to improve the quality and efficiency of financial reporting by the Department. These matters and related recommendations are presented in the accompanying attachment.

We appreciate the cooperation and courtesy extended to our staff during our audit. Should you or your staff have any questions, you may contact me at (202) 927-5400 or a member of your staff may contact Mike Fitzgerald, Director, Financial Audits, at (202) 927-5789.

This memorandum is intended for the use of the management of the Department, however it is available as a matter of public record.

Attachment

cc: Teresa Mullett Ressel, Chief Financial Officer
Marla Freedman, Assistant Inspector General for Audit

Attachment

Financial Reporting for Department of the Treasury (Department) Component Entities Should be Consistent

The Department's financial statements are prepared in conformity with accounting principles prescribed by the Federal Accounting Standards Advisory Board (FASAB), the accounting standards-setting body for the Federal government, as recognized by the American Institute of Certified Public Accountants in October 1999. However, certain Department component entities continue to prepare their financial statements in accordance with accounting standards prescribed by the Financial Accounting Standards Board (FASB), the private sector standards-setting body. These entities include the Bureau of Engraving and Printing (BEP), the United States Mint (Mint), the Office of Thrift Supervision (OTS), the Exchange Stabilization Fund (ESF), the Federal Financing Bank (FFB), and the Community Development Financial Institution Fund (CDFI).

Although the FASAB has allowed entities that issued financial statements prior to October 1999 using FASB accounting principles to continue to do so, this has resulted in inconsistent and incomplete financial reporting by the Department's component entities. It has also inhibited preparation of consolidated Department statements, since, in order to consolidate entities reporting on a private sector GAAP basis, the additional information required for Federal GAAP reporting must be developed, mapped and submitted to the Department's data warehouse by component entities. On occasion, conversion errors in these component entity processes have resulted in reporting errors by the Department. For example, the Department's FY 2002 consolidated statements had to be restated to properly record seigniorage related to circulating coins delivered by the Mint. This likely would not have been necessary if seigniorage had been reported in accordance with Federal GAAP in the Mint's financial statements.

The limitations of using private sector GAAP for Federal reporting entities are substantial. Private sector GAAP does not contemplate budgetary reporting and therefore components using this basis of accounting do not prepare statements of budgetary resources (SBR) or statements of financing (SOF), although these statements are an integral part of the Department's financial statements. Moreover, information reported in the Department's SBR must be reconciled to enacted amounts in the President's Budget and disclosed in the footnotes to the Department's financial statements. Considerable additional preparation and audit steps are required to develop and report this data at the Department level for components using private sector GAAP.

Another major limitation of private sector GAAP is that it does not provide adequate information regarding the costs of programs and activities, since costs are aggregated in the statement of operations to arrive at a single net income figure. The statement of net cost (SNC) required by Federal GAAP requires that costs and offsetting earned revenues be presented by responsibility segments, with net costs identified for each of the segments. This provides more meaningful information to evaluate the operating results of each of an entity's major activities.

There are also significant inconsistencies in how certain costs are reported by entities using private sector GAAP. For example, Federal GAAP requires that non-reimbursed costs paid by the Office of Personnel Management for retirement plans be recognized by the receiving entity as an imputed cost in order to report the full cost of operations. The imputed cost should be reported in the SNC, with the related imputed financing reported in the SOF. Since private sector GAAP does not require either of these statements, this imputed cost is being reported inconsistently, or not at all, by the Department's component entities. For example, Mint and CDFI report offsetting amounts in their statements of operations; BEP discloses the amount of costs paid by OPM in the footnotes but does not include it in its statement of operations; and, OTS does not report the portion of these costs paid by OPM.

Finally, private sector GAAP does not require management's discussion and analysis (MD&A) of the information presented in the annual report. The MD&A is one of the most valuable aspects of an annual financial report, since it provides management's assessment of key trends, fluctuations, and unusual items. It should also link financial and performance information to provide meaningful analysis of the cost benefit relationships of program accomplishments. Several of the Department's component entities using private sector GAAP do not present an MD&A in their annual reports.

The continued use of private sector GAAP by certain component entities undermines the quality, consistency and usefulness of information reported by these entities. It also limits comparability with other component entities reporting on a Federal GAAP basis. In order to strengthen and standardize financial accounting and reporting throughout the Department, all component entities should be required to prepare their financial statements in accordance with Federal GAAP, unless statutorily required to report on a different basis of accounting.

We note that one component entity, the Office of the Comptroller and the Currency (OCC) has already taken the initiative and changed its financial reporting basis from private sector GAAP to Federal GAAP. This has resulted in significantly more useful information for users of the OCC annual report.

Recommendations

We recommend that the Department research and determine whether component reporting entities reporting on a basis other than Federal GAAP are required to do so by statute. We further recommend that (1) all reporting entities within the Department prepare their financial statements in accordance with Federal GAAP, unless statutorily required to report in accordance with a different basis of accounting, and (2) entities that are statutorily required to report on a basis of accounting other than Federal GAAP provide supplemental information in their annual reports that meets the reporting requirements of Federal GAAP, to include an MD&A.

Financial Reports Should Be Analytically Reviewed

The Department has made significant progress in implementing interim financial reporting. The "3-day close initiative" has enabled the Department to prepare monthly financial highlight reports within a short period of time. Also, quarterly financial statements are required to be prepared in accordance with the Office of Management and Budget Bulletin 01-09, *Form and Content of Agency Financial Statements*. The Department's progress in these areas is noteworthy, however controls over interim financial reporting processes need to be further strengthened to improve the quality and reliability of the data.

The Department uses its 3-Day Close Data Quality Scorecard to assess the quality of monthly data submitted by its bureaus. This scorecard generally serves as a data input check to ensure that, for certain critical accounts, balances are submitted, are properly recorded as debits or credits, properly coded, and reflect periodic changes. This provides a useful mechanical check over data submissions, however, it does not provide an analysis of the reasonableness of the balances, nor explanations for unusual variances. The data quality checks need to be supplemented by analytical review procedures to evaluate the overall plausibility of the data and the relationships of this data to other benchmark information.

The need for better review and analysis of interim financial data was highlighted by the late identification of major discrepancies in the way budgetary accounts related to the public debt were recorded in the draft FY 2003 SBR. Unusual fluctuations in these accounts resulting from the FY 2002 adoption of new budgetary accounting for interest on public debt securities were not reviewed until after the FY 2003 year end, and, upon analysis, major adjustments and restatements were required. Careful review and analysis of these accounts on a regular basis throughout the year would have identified and corrected these discrepancies on a timely basis.

Each component entity should perform an overall review of their monthly financial data for accuracy, completeness, and quality. This should include investigating and explaining any unusual balances, incorrect beginning balances, and significant fluctuations in balances. It should also include an analysis of the methodology and data used in developing estimates for interim financial reporting. In addition to comparisons with financial data from prior reporting periods, analytical review procedures should compare actual data with anticipated results, such as budgeted or forecasted data for the current interim period.

Analytical review procedures should also be applied to examine relationships between financial data and relevant non-financial information, such as program performance data. In the Federal environment this type of analysis can be ultimately the most meaningful, since it provides information to evaluate efficiency and cost effectiveness in achieving program and operational objectives.

The Department should oversee and monitor analytical reviews performed by its component entities, and perform additional reviews and analyses of the consolidated data to ensure the quality and reliability of the financial reporting of the Department as a whole. These additional controls over the interim reporting process should enable more accurate and reliable financial information throughout the year.

Recommendation

We recommend that analytical review procedures be implemented as an integral part of interim financial reporting at the individual bureau level as well as the Department level. The results of these analytical reviews should be documented in brief narratives accompanying the financial reports.

The Process for the Preparation of the Annual Performance and Accountability Report Can be Strengthened

The Department has successfully accelerated issuance of its annual performance and accountability reports (PAR) for two consecutive years. This reflects significant improvements already made in the PAR preparation process that have enabled these reports to be issued on a more timely basis. Nonetheless, we identified several areas where additional improvements could be made to strengthen the preparation process and improve overall quality control. These areas are summarized below:

Continue refining the process used to prepare the PAR

We identified the following areas in the preparation process where better efficiencies could be realized:

- The Department maintained multiple data files for the draft PAR and its supporting schedules which resulted in confusion in the identification and use of updated files. We noted instances where changes were made to the old files instead of the latest files causing the Department to update files multiple times.
- Incorrect formulas were used in the supporting Excel spreadsheets, resulting in footing and cross-footing errors and/or amounts on the spreadsheets not agreeing with the balances in the PAR.
- The schedules (i.e. financial statements and notes) in the PAR master file were not formulated and linked. The Department had to manually change all related account balances each time an adjustment or a correction was made to an account balance. With proper formulas and links, any changes made to an account balance will automatically calculate down or be updated in financial statements, notes and MD&A
- The window for submission of performance data was kept open after the PAR preparation and audit timeline cutoff date and a new version of the draft performance data was generated each time a new set of information was submitted. As a result, extra time was spent by the Department in preparing and reviewing multiple drafts.
- Performance data for FYs 2000 and 2001 reported in the FY 2003 PAR was not consistent with data reported in the FY 2002 PAR because bureaus were allowed to submit new data for prior FYs.
- Narrative information in the performance report and the prior year performance measures, which could have been finalized before the end of the year, were not finalized until after the revised draft PAR was prepared.

Strengthen supervisory review and quality control

During our review of the draft PAR, we noted many errors and inconsistencies such as (1) footing and cross-footing errors, (2) inconsistencies between the financial statements and notes, (3) amounts from the supporting schedules not in agreement with the amounts presented in the PAR, and (4) inconsistencies in financial and performance data reported in multiple sections of the PAR. These types of discrepancies should be detected and corrected by supervisory review and quality control procedures applied to the PAR.

Recommendations:

We recommend that the Department:

1. Continue to improve the efficiency of the PAR preparation process by taking the following steps:
    - Maintain one set of master files for the draft and final PAR
    - Review the supporting Excel spreadsheets for correct formulas before the data is presented as support for the amounts in the PAR
    - Ensure that the schedules in data file for the PAR are formulated and linked
    - Enforce cut-off time for the submission of performance report data by the bureaus
    - Ensure consistent reporting of prior year performance measures. Bureaus should not change performance data for a FY more than a year after the end of that particular FY
    - Finalize the narrative information in the performance report and the prior year performance measures in the first draft of the PAR

2. Strengthen supervisory review and other quality control measures to ensure the accuracy, consistency and completeness of financial, performance and other information presented in the PAR. This should be accomplished primarily through a closer supervisory review, however additional quality control procedures should also be applied. Use of a checklist such as the CFO Act Checklist included in Section 1004 of the *GAO/PCIE Financial Audit Manual* would be a useful tool for this purpose.